

Via email to regcomments@ncua.gov

March 5, 2010

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Corporate Credit Unions Proposed Rule published December 9, 2009
12 CFR Parts 702, 703, 704, et al.

Dear Ms. Rupp:

On behalf of the Board and management of Corporate One Federal Credit Union, I would like to take this opportunity to comment on the recently issued Proposed Rule published December 9, 2009.

The NCUA has published for comment a Proposed Rule that is designed to address key issues that have arisen within the corporate system in order to strengthen each corporate and the system as a whole. The following comments are being submitted in response to the Proposed Rule. Our comments are in order as they appear in the regulation and are not in order of importance.

Sincerely,



Lee C. Butke
President and CEO

The issue of legacy assets is not addressed in the proposed regulation and has become a major discussion point in the credit union community. Thus we would like to comment on this subject before we comment on the proposed regulation.

The ultimate cost of the resolution of the corporate crisis will be influenced by the actions to resolve this issue. We feel compelled to place some guiding principles forward for the resolution, as we see “time” as ultimately the best solution for the least cost resolution. The economic value of these legacy assets is most certainly better than the current market prices, and consideration must be given to the difficulty in establishing a fair value price for these bonds.

The corporate system has primarily used the same third party source for modeling the underlying assumptions and loss projections to determine the other than temporary impairment charges taken throughout the network. The extensive use of, and the concentration of the network in one single analytical firm is a systemic risk that must also be recognized.

Recommendations:

The following principles should be applied to the legacy asset resolution as a test for the proposed solution:

1. First, do no harm. The solution must not further impact the credit union movement by creating new additional losses to the fund, credit unions, or to an individual corporate.
2. Second, insure that the legacy assets are transferred or managed in such a way as to allow for their ultimate resolution through amortization, therefore maximizing the economic value over time.
3. Third, if assets are isolated, managed and controlled by the agency or by any other entities, those assets should only be liquidated if the economic value of the bond can be achieved by the sale. A sale that is made simply when an improvement in the market price is above the transfer price of the asset solves a short-term problem but does not insure that the greatest economic value will be returned to the credit union movement.
4. Fourth, as the credit union movement must bear the ultimate cost of these bonds, it is our position that the agency develop a methodology that allows for the effective management of potential losses associated with these assets over time, and to avoid any solution that will not achieve the most beneficial long-term result for the movement or for individual members of a corporate.

By following these principles we can all better achieve the full economic value of the legacy assets over time.

Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Pages 65245, 65246

Brief Description:

This section of the regulation developed a model using a sample portfolio constructed within the proposed limits for investment concentration and weighted average asset life (WAL).

Discussion:

We recognize the model is a representation of a possible portfolio. However, we feel it is important to recognize some of the challenges inherent in the assumptions used, as failure to achieve the projected 20 basis points leads to failure of the new PCA requirements.

We believe the following observations are relevant to the discussion of the model:

1. No PCC or NCA is included in the model, nor is the cost. We recommend that the model reflect required PCC of 4% to meet the 12-month timeframe set forth in the leverage ratio requirements (see section 704.2(8) FR page 65264 of the proposed regulation) and that a cost of capital be assigned of Libor +100.
2. The Private Student Loan ABS category has proven to be a good investment for us. However, there is a liquidity premium associated with these assets and we would be hesitant to commit the percentage indicated in the model. Additionally, the weighted average life (WAL) of .5 years appears to be low, as most of the new issues that would earn the wide spread indicated in the model have a WAL of greater than two years.

Recommendations:

The model relies heavily on the private student loan ABS category to generate the 34 basis points of net interest income. The NCUA should ensure that the assumptions surrounding this asset class, in particular, are reasonable. Additionally, the cost of capital should also be incorporated into the model.

**Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Pages 65260, 65262, 65264
§704.2**

Brief Description:

§704.2 Definitions.

Adjusted total capital means total capital modified as follows: To the extent that nonperpetual contributed capital accounts are included in total capital, and the sum of those NCAs exceeds the aggregate of the corporate's PCC and retained earnings, the corporate will exclude the excess from adjusted total capital.

Leverage ratio means, before [DATE 36 MONTHS AFTER DATE OF PUBLICATION OF FINAL RULE IN THE **FEDERAL REGISTER**], the ratio of adjusted total capital to moving daily average net assets.

Leverage ratio means, on or after [DATE 36 MONTHS AFTER DATE OF PUBLICATION OF FINAL RULE IN THE **FEDERAL REGISTER**], the ratio of adjusted core capital to moving daily average net assets.

Effective [DATE 12 MONTHS AFTER DATE OF PUBLICATION OF FINAL RULE IN THE **FEDERAL REGISTER**], revise §704.3 to read as follows:

§704.3 Corporate credit union capital,

- (a) *Capital requirements.* (1) A corporate credit union must maintain at all times:
 - (i) A leverage ratio of 4.0 percent or greater

Discussion:

Based upon the various timeframes discussed in the proposed regulation, it appears that the intent was to allow for a period of 36 months to build all forms of capital: retained earnings, Perpetual Contributed Capital (PCC) and nonperpetual contributed capital (NCA). As time progresses, the rule appropriately moves the focus from all forms of capital to a specific focus on retained earnings. The concept of a transition period is needed and we support such a transition.

However, the leverage ratio definition refers to adjusted total capital which limits NCAs to the aggregate of PCC and retained earnings. Combining this definition with the requirement of achieving a 4% leverage ratio twelve months after the date of publication of the final rule results in NCAs not being an effective capital tool. The definition as written will drive corporates to immediately issue PCC to meet the leverage ratio of 4% within the 12-month period. PCC is the highest cost of capital and will limit the ability to build the most critical type of capital – retained earnings. Unintended consequences may also include credit unions being forced to find other service providers if they are not willing to immediately invest in PCC.

Recommendations:

We recommend that the definition of adjusted total capital found in §704.2 be deleted and the reference to adjusted total capital in the definition of the leverage ratio be changed to total capital.

Alternatively, the NCUA could gradually increase the leverage ratio requirement over time. For instance, section §704.3 could be modified to require a leverage ratio of 2% twelve months after the final rule, 3% twenty-four months after the final rule and 4% thirty-six months after the final rule.

Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65271
§704.6(c)

Brief Description:

§704.6 Credit risk management.

(c) Issuer Concentration Limits-

(1) General rule. The aggregate of all investments in any single obligor is limited to 25 percent of capital or \$5 million, whichever is greater.

Discussion:

The lack of adequate diversification was a major problem that contributed to the corporate system issues. Failure to adequately diversify resulted in concentrations of credit exposure as well as liquidity issues. Section 704.6(d) of the proposed regulation is well written and lays a solid diversification framework wherein concentration limits and capital go hand-in-hand.

In addition to adding the sector concentration limits found in §704.6(d), the proposed regulation tightens the aggregate investment in any single obligor to 25 percent of capital or \$5 million, whichever is greater. The interaction of the sector limitations and obligor restrictions each look logical on the surface; however, when combined, the two restrictions may lead to a greater concentration in assets that simply have the greatest number of issuers/obligors or the restrictions may actually push corporates to invest in lower quality obligors than they otherwise would.

To illustrate our point, consider a corporate with daily average net assets of \$3.0 billion and capital of 5% or \$150 million. The sector limitation is very robust allowing up to the lower of 500 percent of capital (\$750 million) or 25 percent of assets (\$750 million). However, each obligor within that sector would be capped at 25 percent of capital (\$37.5 million). To fully invest in a particular sector, the corporate in our example would need to find 20 high quality obligors to fully participate in the sector.

In structured finance, not all sectors have the same breadth of market participants (obligors) or utilize the same structures. Obligor is defined by the regulation as “the primary party obligated to repay an instrument.” The credit card asset-backed security sector is dominated by the master trust and issuance trust structures whereby a large, managed pool of revolving card receivables underlies a series of notes issued in a multi-tranche structure with stated minimum credit enhancement levels. Each subsequent issue is supported by the same revolving collateral pool. Because of the sheer size of the collateral pools, the performance of the collateral is relatively stable and the loans are generally well-seasoned. Due to years of industry and banking consolidation, there are six major, top-tier credit card asset-backed security issuers/obligors. The collateral pools supporting the trusts issued by these obligors consist of a diversified pool of consumer bankcard receivables. There is another significant player in the credit card asset-backed security market; however, their receivables are mostly retail card receivables purchased from large but discrete national retailers. Corporate One only invests in the six top-tier names because we believe they are of higher credit quality and more liquid than credit

card trusts issued by others. In 2009, credit card asset-backed security issuance was approximately \$60 billion, down from \$76 billion in 2008. Only seven issuers comprised all but 3.8 percent of the rated transactions in 2009.

Going back to our example corporate, if such corporate wanted to invest in the credit card asset-backed security sector and they limited themselves to the top six obligors, they would actually only be able to invest \$225 million (6 obligors x \$37.5 million each) in this sector. This illustrates that a corporate might actually be forced to invest in lower quality obligors to more fully invest in a particular sector.

Mortgage-backed securities on the other hand are packaged into separate and distinct trusts. Therefore, by virtue of the way the securities are packaged, there are more issuers/obligors. The corporate in our example, limited to only \$225 million in the credit card sector because of the obligor limits, may now be incented to invest more heavily in the mortgage-backed security sector.

Additionally, the proposed limit forces investment into higher risk or less-seasoned sectors such as the equipment lease sector, as the investment classes are structured differently than the credit card sector.

We believe that the overriding issue within the corporate network was a failure to establish reasonable sector concentration limits, and was not caused by obligor concentration issues.

Federal Funds transactions are not currently addressed in the proposed regulation. The same issue applies to the Federal Funds market as we described for the structured finance market, in that the number of high quality participants is limited. Accordingly, we believe the single obligor limit of 25 percent of capital is also too limiting.

The prescriptive obligor limit applied to deposits in other depository institutions is also not practical. In the normal course of our payment system operations, we utilize various large financial institutions as endpoints to clear member transactions. The financial institution selections are risk-based. In providing our forward check collection service to our members, we send items for collection to certain large financial institutions that then deposit the total collected balances into our account at their institution. We direct items for collection to particular financial institutions based on a "least-cost routing" methodology to optimize the availability of funds and to get the best price for our members. We typically withdraw the total collected balances the following day. Although deposits in other depository institutions are excluded from the sector concentration limits, it appears that our deposits would be limited based on the obligor concentration limits to 25 percent of capital or \$5 million, whichever is greater. There are a limited number of financial institutions capable of clearing large files of electronic items at a reasonable cost and the concentration of such financial institutions varies regionally. Accordingly, we believe the single obligor limit of 25 percent of capital is too limiting for deposits at financial institutions.

Recommendation:

Ideally the regulation should eliminate the prescriptive obligor limits and require corporates to set reasonable, risk-based obligor limits within their credit policies. Corporates could then set obligor limits at different levels for different sectors.

If obligor limits remain in the final regulation, we recommend that obligor limits be more granular and sector specific. For certain sectors, we recommend that the issuer concentration limits found in §704.6(c)(1) be revised to allow a greater concentration in any single obligor. Alternatively, at a minimum, the obligor limits should be the same as the regulation currently allows -- 50 percent of capital or \$5 million, whichever is greater.

If obligor limits remain in the final regulation, Federal Funds as well as other overnight investments should be specifically addressed in the exceptions found in §704.6(c)(2) to allow for higher, risk-based obligor limits such as 200 percent of capital.

If obligor limits remain in the final regulation, deposits in other depository institutions should be specifically addressed in the exceptions found in §704.6(c)(2) to allow for higher, risk-based obligor limits such as 400 percent of capital.

Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65271, 65272
§704.6(d)

Brief Description:

§704.6 Credit risk management.

(d) Sector Concentration Limits.

- (1) A corporate credit union must establish sector limits that do not exceed the following maximums: [list (i) through (ix)]
- (3) A corporate credit union will limit its aggregate holdings in any investments not described in paragraphs (d)(1) or (d)(2) to the lower of 100 percent of capital or 5 percent of assets. The NCUA may approve a higher percentage in appropriate cases.
- (4) The following investments are also excluded from the concentration limits in paragraphs (d)(1), (d)(2), and (d)(3): Investments in other federally insured credit unions, deposits in other depository institutions, and investment repurchase agreements.

Discussion:

We believe that concentration in certain asset classes was one of the root causes of the issues within the corporate credit union network. Diversification is key to managing risk within an investment portfolio. Accordingly, we agree that the NCUA should include sector concentration limits in the final regulation. However, the proposed regulation is very prescriptive and only addresses current asset classes.

We expect that new classes will be developed that may be excellent tools for investing. As an example, 2a7 money market account rules have recently been revised and these funds are now even more liquid with lower risk. We also see potential new structures developing in securitizations that will enhance the instruments. For example, covered bonds are debt securities that are backed by the cash flows of predetermined assets on a financial institution's balance sheet. These assets are similar to an asset-backed security, but instead of the loans being placed in a bankruptcy-remote trust they remain on the balance sheet of the underlying issuer. This is an asset class that will likely replace many asset-backed securities in the future and is likely to be structured in a safer manner than the current structured finance sector is today. Therefore, having the flexibility to adapt to new (less risky) investments should be considered.

Federal Funds transactions are not currently addressed in the proposed regulation. Although Federal Funds transactions are not substantially different than regular deposits in other depository institutions, deposits in other depository institutions are actually excluded from the sector concentration limits under §704.6(d)(4). Because Federal Funds transactions are not specifically addressed or excluded from the concentration limits, §704.6(d)(3) would limit aggregate Federal Funds transactions to the lower of 100 percent of capital or 5 percent of assets. This overnight investment product has been successfully relied on by corporates and the proposed regulation would limit a corporate's access to the Federal Funds market.

Certain money market accounts are now available in the overnight investment market. Money market accounts have recently been enhanced in regard to credit quality and liquidity and are an excellent liquidity storehouse. Therefore, we believe these accounts should be added to the list of investments excluded from the concentration limits.

Recommendation:

The regulation should permit the NCUA Board/Office of Corporate Credit Unions to add additional sectors and sector concentration limits to allow for the timely use of new emerging asset classes and to avoid the need to modify the regulation in the future.

Federal Funds and money market instruments, among other overnight investments, should be added to the list of investments in §704.6(d)(4) that are excluded from the concentration limits.

Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65272
§704.8(c)

Brief Description:

§704.8 *Asset and liability management.*

(c)Penalty for early withdrawals. A corporate credit union that permits early share certificate withdrawals must redeem at the lesser of book value plus accrued dividends or the value based on a market-based penalty sufficient to cover the estimated replacement cost of the certificate redeemed. This means the minimum penalty must be reasonably related to the rate that the corporate credit union would be required to offer to attract funds for a similar term with similar characteristics.

Discussion:

The continued use of a penalty formula based upon replacement costs of deposits may not achieve the desired results as suggested by the agency in the preamble.

As a case in point, the credit union purchases a three-year 5% certificate of deposit. The corporate then uses the proceeds to purchase a security, creating an appropriate return and funding match. One year later, the market experiences a dislocation and certificate funding rates fall dramatically and are at 1% for two years. At the same time, the asset funded by the certificate experiences a spread widening of 500 basis points over swaps. This is an example of the market dislocation we experienced recently. In this example, with swaps widening coupled with wider spreads over swaps, the discount rate used to calculate the market price for the asset is 6%. Therefore, we believe the discount rate used to calculate the mark-to-market penalty on the certificate should be slightly higher than 6% (the difference between the bid and ask). The penalty as proposed in this regulation would be the lesser of the carrying value of the certificate or the cost of the replacement. So, in our example, the certificate would simply be redeemed at par. However, the corporate has an asset on their books that is priced below par and may need to be sold in order to fund the certificate redemption or to remain within the proposed duration mismatch requirement. The penalty in this example did not address the “unwinding” of the asset that is now below par. This will become more important due to the tight WAL restrictions and duration mismatch. Conversely, when market spreads tighten and interest rates decline, a gain would be paid on the redemption of the certificate. In our opinion this would be fair to credit unions, because in this case the market value on the underlying asset has significantly improved -- resulting in a gain to the corporate.

We believe that a corporate must have the ability to charge a mark-to-market price for all certificate redemptions, which should be reflective of the market value of the purchased asset and not based on the funding side. This ensures that the corporate’s certificate redemption price adequately covers the cost of selling the underlying asset that was purchased to match against the certificate. Market factors, including rates, swap spreads, and spreads over swaps on the underlying asset, should be used to determine whether a certificate is redeemed at a gain or a loss.

The rule as written continues to focus on “replacement funding”, which contributed to the liquidity issue at many corporates during this most recent financial crisis. In other words, gains were being paid based on the replacement cost of the certificates being redeemed and not on a true marked-to-market penalty. Therefore, the corporate was then left with an asset that could not be sold to fund the redemption. Although the proposed rule does not permit gains on any certificate redemptions, it still does not adequately address market dislocations.

Recommendations:

We recommend a true marked-to-market based asset redemption price that would allow for losses and gains, but would base the discount rate on the unwinding of the asset that underlies the liability.

Alternatively, the wording in §704.8(c) should be modified to permit the corporate to charge a penalty of their choosing, to allow for protection against market dislocation of the underlying assets.

**Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65272
§704.8(d)(1)**

Brief Description:

§704.8 Asset and liability management.

(d) Interest rate sensitivity analysis.

(1) A corporate credit union must:

(i) Evaluate the risk in its balance sheet by measuring, at least quarterly, the impact of an instantaneous, permanent, and parallel shock in the yield curve of plus and minus 100, 200, and 300 bp on its NEV and NEV ratio. If the base case NEV ratio falls below 3 percent at the last testing date, these tests must be calculated at least monthly until the base case NEV ratio again exceeds 3 percent.

Discussion:

This section of the regulation, as written, is acceptable. However, “core deposits” are not given the appropriate value in the NEV calculation as a result of the Corporate Guidance Letter 2003-3. The letter was entitled Modeling Non Maturity Shares and Deposits and stated “valuation at book value will provide reliability in application of the regulatory NEV limits.” The judgmental elements associated with modeling were effectively removed and replaced with a standardized approach that provided “equality” but did not enhance the effectiveness of the model.

We believe the 2003 guidance is outdated and should reflect new thought regarding the use of core clearing balances that are tied to payment systems activity. New tools are envisioned such as “compensating” or “required clearing balances” which are related to a specific activity such as settlement or other payments activity, but no consideration for these new tools is present in the old guidance. As an example, a corporate that contractually requires a credit union to place an amount on deposit that represents their highest daily clearing debit in order to do check processing would be given no consideration in the NEV calculation for this core deposit. Institutional core deposits behave differently than retail deposits, but when contractually obligated to provide an offsetting clearing balance the current guidance would not allow this “non maturity deposit” to be given core value in the NEV calculation.

These tools can also help insure adequate liquidity is present, and by modifying the old guidance these new tools can be encouraged. There should be a benefit assigned to these types of contractual clearing accounts and their use encouraged.

Recommendations:

Revise the 2003-3 guidance on Non Maturity shares to allow for consideration in the NEV calculation for core deposits, and at minimum permit those deposits that have a contractual commitment associated with settlement and/or payment systems activity to be included.

Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65273
§704.8(e)

Brief Description:

§704.8 Asset and liability management.

(e) *Cash flow mismatch sensitivity analysis.*

(1) A corporate credit union must:

- (i) Evaluate the risk in its balance sheet by measuring, at least quarterly, the impact of an instantaneous spread widening of both asset and liabilities by 300 basis points, assuming that issuer options will not be exercised, on its NEV and NEV ratio. If the base case NEV ratio falls below 3 percent at the last testing dates, these tests must be calculated at least monthly until the base case NEV ratio again exceeds 3 percent;
- (ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (e)(1)(i) of this section below 2 percent; and
- (iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 15 percent.

(2) All investments must be tested, excluding derivatives and equity investments. All borrowings and shares must be tested, but not contributed capital.

(3) A corporate credit union must also test for the effects of failed triggers on its NEV and NEV ratios while testing the cash flow sensitivity analysis.

Discussion:

The intended purpose of this section is to create a shock test with regard to the portfolio's ability to handle credit spread widening or widening caused by market dislocations for illiquidity or other events.

The recent market dislocation clearly demonstrates that different asset classes respond uniquely to these market events. For example, even during the extreme market dislocations we experienced over the last couple of years, spreads on agency and other government-backed assets widened significantly less than non-agency investments. Furthermore, a security with a shorter WAL does not have the same credit spread risk as a security with a longer WAL. Again, even during the worst financial crisis since the Great Depression, short WALs of many sectors (i.e., agency securities, FFELP student loans, ABS auto, ABS credit card) did not widen 300 basis points or if they did it was very short lived before spreads tightened. In addition, a subordinate security has more risk of wider spreads than a security with a senior creditor position and should be treated differently in a credit spread stressed scenario. Yet the proposed rule makes no distinction of the various asset classes and requires a 300 basis point spread widening to all asset types.

Recommendations:

We understand and agree with the need for a measure of the impact that a market dislocation might have on a corporate's NEV. However, the 15% NEV volatility and 300 basis point spread shock does not appropriately allocate risk based on the primary causes of spread widening: WAL, sector and credit rating. An NEV volatility limit of 15% in combination with the spread widening matrix below is a model in which corporates can sufficiently grow retained earnings within the prescribed timeframes while still maintaining a sizeable cash position for liquidity. This approach aligns the credit risk measure with the actual credit risk profile of the corporate. In other words, investments in higher risk asset sectors and longer WALs are subjected to a greater credit spread widening stress.

Our recommended spread widening matrix is as follows:

Asset Sector	Less than 1 yr. WAL	Less than 3 WAL, but greater than 1 year WAL	Greater than 3 yr. WAL
Overnight Deposits – Bank Deposits Federal Funds Mutual Funds	0 basis points	NA	NA
GSEs – Agencies FFELP S/Ls SBA Loan Pools	50 basis points	75 basis points	100 basis points
More Liquid Asset Sectors – Municipals Auto ABS Credit Card ABS Equipment ABS CMBS Corporate Debt Covered Bonds	100 basis points	150 basis points	200 basis points
All Other Sectors	150 basis points	200 basis points	300 basis points
All subordinate securities	200 basis points	250 basis points	300 basis points

Alternatively, if the final rule maintains the 300 basis point spread widening on all assets, then the decline in NEV should be allowed to go to 50% instead of 15%.

**Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65273
§704.8(f)**

Brief Description:

§704.8 Asset and liability management.

(f) *Cash flow mismatch sensitivity analysis with 50 percent slowdown in prepayment speeds.*

(1) A corporate credit union must:

- (i) Evaluate the risk in its balance sheet by measuring, at least quarterly, the impact of an instantaneous spread widening of both asset and liabilities by 300 basis points, assuming that issuer options will not be exercised and prepayment speeds will slow by 50 percent, on its NEV and NEV ratio. If the base case NEV ratio falls below 2 percent, at the last testing date, these must be calculated at least monthly until the base case NEV ratio again exceeds 2 percent;
- (ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (f)(1)(i) of this section below 1 percent; and
- (iii) Limit its risk exposures to levels that do not result in a decline in NEV of more than 25 percent.

(2) All investments must be tested, excluding derivatives and equity investments. All borrowings and shares must be tested, but no contributed capital.

(3) A corporate credit union must also test for the effects of failed triggers on its NEV and NEV while testing the cash flow sensitivity analysis.

Discussion:

The extension of certain asset classes during the most recent financial crisis seems to be the driver for creating the proposed cash flow mismatch sensitivity analysis or stress test.

During this most recent crisis not all asset classes experienced such a slowdown, or had such spread widening. For example, we saw vast differences in the slow down of private label mortgage-backed security prepayment speeds versus those of agency mortgage-backed securities. Additionally, cash flow prepayments slowed significantly for private label mortgage-backed securities, while student loan asset-backed securities, as constructed, have fairly slow prepayment speeds and therefore we did not see as much of a slow down in prepayments for this sector. The proposed rule does not provide adequate differentiation as to the type of investment or its structure when applying the blanket 50 percent prepayment slow down. Unintended consequences may result when all assets are treated similarly with extreme shock tests.

Recommendations:

A more granular approach to the modeling of the stress ranges should be established as various asset classes and structures do perform differently under stress, such as:

Asset Sector	Prepayment Speed Slowdown
Private-Label Mortgages	50%
Agency Mortgages	25%
All other prepayment sensitive asset sectors	15%

Using the credit spread recommendation in §704.8(e) coupled with the recommended prepayment slowdown test above, we believe the NEV volatility risk limit of 25% will permit corporates to take an acceptable amount of risk and still meet the prescribed capital requirements over time.

Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65273
§704.8(h)

Brief Description:

§704.8 Asset and liability management.

(h) *Weighted average asset life.* The weighted average life (WAL) of a corporate credit union's investment portfolio, excluding derivative contracts and equity investment, may not exceed two years.

Discussion:

We believe that the NCUA added this restriction to address credit and liquidity risks. However, we think these risks have been adequately addressed in other parts of the proposed regulations. For example, the NEV volatility test with the spread widening and the prepayment speed slowdown will restrict the percentage of investments in longer WAL securities. However, with a couple of modifications, we are not opposed to a two-year WAL restriction.

A corporate's investments are generally managed in three separate portfolios: overnight, term and capital. The overnight and capital portfolios are typically managed on a repricing basis, as opposed to a matched funding basis. Therefore, the two-year WAL restriction is appropriate. However, because this restriction is only applied to the asset side and disregards the liabilities it is not appropriate for the term portfolio. If the term portfolio is run as a "matched book" and an appropriate early redemption penalty is applied (see our comments on §704.8(c) for our views on appropriate early redemption penalties), the portfolio would have minimal interest rate and liquidity risks. By eliminating the term portfolio assets from the WAL test but requiring the use of a "funding match" methodology, we can better meet our members' term investment needs. For example, if the yield curve steepens and loan demand declines, credit unions may want to extend the duration of their investment portfolio and we may not be able to accommodate their investment needs under this test. The minimal risk posed by the funding mismatch will also be monitored in the calculation of the NEV volatility tests.

If the WAL restriction is to manage liquidity risk and credit risk, then government-sponsored enterprises (GSE) and government-backed securities should be excluded from the calculation.

Recommendations:

We agree with the 2-year WAL restriction for the assets in the overnight and capital portfolios. However, we recommend eliminating a corporate's term portfolio assets from the 2-year WAL calculation and instead require a maximum funding mismatch of one year for the term portfolio.

We also recommend that GSEs and government-backed securities be eliminated from the WAL calculation.

Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65273, 67274
§704.9(a), §704.9(b)(1)

Brief Description:

§704.9 Liquidity management.

(a) *General.* In the management of liquidity, a corporate credit union must:

- (1) Evaluate the potential liquidity needs of its membership in a variety of economic scenarios;
- (2) Regularly monitor and demonstrate accessibility to sources of internal and external liquidity;
- (3) Keep a sufficient amount of cash and cash equivalents on hand to support its payment system obligations;
- (4) Demonstrate that the accounting classification of investment securities is consistent with its ability to meet potential liquidity demands; and
- (5) Develop a contingency funding plan that addresses alternative funding strategies in successively deteriorating liquidity scenarios. The plan must:
 - i. List all sources of liquidity, by category and amount, that are available to service an immediate outflow of funds in various liquidity scenarios;
 - ii. Analyze the impact that potential changes in fair value will have on the disposition of assets in a variety of interest rate scenarios; and
 - iii. Be reviewed by the board or an appropriate committee no less frequently than annually or as market or business conditions dictate.

(b)(1) *Secured borrowings.* A corporate credit union may borrow on a secured basis for liquidity purposes, but the maturity of the borrowing may not exceed 30 days. Only a credit union with core capital in excess of five percent of its moving DANA may borrow on a secured basis for nonliquidity purposes, and the outstanding amount of secured borrowing for nonliquidity purposes may not exceed an amount equal to the difference between core capital and five percent of moving DANA.

Discussion:

We agree with the general requirements set forth in §704.9(a). This section requires the development of appropriate measures and plans to manage liquidity risk and follows the recent proposal set forth in the FFIEC interagency (included NCUA) guidance on funding and liquidity risk management.

However, §704.9(b)(1) then establishes a prohibition regarding secured borrowings in that they may not exceed 30 days. This prohibition is at odds with the Federal Financial Institutions Examination Council (FFIEC) guidance, as it will prohibit the development of a sound and reliable contingency funding plan. The regulation as proposed, limits secured borrowing, which is the most reliable form of contingent funding.

As an example, committed bank lines, secured repo lines, as well as Federal Home Loan Bank secured borrowings are excellent contingency funding tools and were available, although stressed, during the most recent financial crisis. Unsecured borrowing under any terms and conditions were non-existent and unavailable to even the most credit-

worthy borrowers. Secured borrowings were still available immediately before and after the Lehman Brothers collapse, which was one of the most “stressed” periods in recent history.

A well-constructed liquidity management strategy must formulate and have in place “plans and courses of actions for dealing with temporary, intermediate-term, and long-term liquidity disruptions” per the FFIEC guidance. These same plans should also be coordinated with “disaster and contingency planning.” The proposed regulation suggests that a greater reliance should be placed on unsecured funding in developing contingent funding plans for stress scenarios and we do not believe this to be prudent. The limitation in Section 704.9(b)(1) needs careful consideration as it increases reliance on unsecured borrowings which may not be available in stress scenarios.

Section 704.9(b)(1) also contains wording that restricts borrowing to an amount not to exceed the difference between core capital and five percent of moving DANA, and grants this authority to only those with core capital in excess of five percent of moving DANA. The proposed regulation would only grant this ability to those that are defined as “well capitalized” by the new definition standards, but would still restrict the borrowing amount to the difference. Therefore as written, if a corporate credit union has 6% core capital, it would only be able to borrow 1% of DANA under this restriction. For each \$1 billion in DANA, this formula would yield only \$10 million in borrowing, for a corporate credit union that is considered “well capitalized.” This restriction carries the borrowing restriction too far and consideration should be given to providing greater authority as the corporate moves from an adequately to well-capitalized position.

Recommendations:

Section 704.9(b)(1) should be eliminated entirely.

Alternatively, if the NCUA feels some limitation is in order, the final regulation should provide for a period of 120 days of secured borrowing instead of the currently proposed 30 days. This would permit secured borrowings to be a practical part of any contingency funding plan.

Additionally, if §704.9(b)(1) remains in the final regulation, it should be modified to allow a greater amount of borrowing capacity for “well capitalized” corporate credit unions. Therefore, we suggest that the last part of §704.9(b)(1) be modified as follows: “Only a credit union with core capital in excess of five percent of its moving DANA may borrow on a secured basis for non-liquidity purposes, and the outstanding amount of secured borrowing for non-liquidity purposes may not exceed an amount equal to the difference between core capital and five percent of moving DANA divided by ten percent.”

Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65274
§704.11(e)

Brief Description:

§704.11(e) *Permissible activities*. A corporate CUSO must agree to limit its activities to:

- (1) Brokerage services,
- (2) Investment advisory services, and
- (3) Other categories of services as approved in writing by the NCUA and published on NCUA's website.

Discussion:

The safeguards that surround CUSO activities are already sufficient without requiring the approval of "activities." Section 704.11 already contains several points of control over the "safety and soundness" issues related to CUSO activities. For example, specific prohibitions are present in §704.11(g)(4), which restricts investments in another depository institution, insurance company, trade association, liquidity facility, or similar organization.

The approval of activities adds controls where they are not needed. Further, approving an activity does not assure it is a sound investment and/or that it will be operated in a safe and sound manner.

The permissible CUSO activities list included in the proposed regulation is not representative of current corporate CUSO activities that are being operated successfully and safely. Excellent CUSO examples other than those provided in the proposal are present, including item processing and cooperative data processing. If the NCUA includes §704.11(e) in the final regulation, then these types of shared resource CUSOs should be encouraged and identified as acceptable activities.

Section 704.11(e), as written, does not provide any guidance on what is deemed to be an "acceptable" activity nor does it outline the approval process.

Recommendations:

Section 704.11(e) should be deleted entirely from the final regulation.

If the NCUA includes §704.11(e) in the final regulation, it should have the following activities added to the list: shared services, item processing and shared data processing. Additionally, the concept of "acceptable activities" should be explained in this section or defined in §704.2. Further, NCUA should outline the process and approval criteria for a new category.

Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65274
§704.14(a)(2), 704.14(a)(3), 704.14(a)(4)(5)(6)(7)(8)

Brief Description:

§704.14 Representation.

(a)(2) On or after [DATE 4 MONTHS AFTER DATE OF PUBLICATION OF FINAL RULE IN THE **FEDERAL REGISTER**], only individuals who currently hold the position of chief executive officer, chief financial officer, or chief operating officer at a member may seek election or re-election to the board;

(a)(3) No individual may be elected to the board if, at the expiration of the term to which the individual is seeking election, the individual will have served as a director for more than six consecutive years.

Discussion:

Section 704.14(a)(2) restricts the individuals eligible to serve by titles/position and is not written in a way to permit those otherwise qualified to serve. Thought should be given to an exception process wherein an individual could be approved to serve based on their qualifications and not just their title/position. The titles/positions listed should also be expanded to include such individuals as a Chief Investment Officer and Chief Risk Officer.

Section 704.14(a)(3) restricts term limitations to six consecutive years. As a member-owned institution, we do not believe that term limits should be included in regulation. Such restriction will create turnover in corporate Boards. Turnover will not provide for the development of the needed knowledge and skills required to be a director, nor will it provide for continuity of leadership. It will also result in the loss of corporate knowledge of the recent events we have just experienced. Further, if implemented, the overall experience level of the entire Board of Directors will only average three years. In our own organization, if this requirement were in place, the annual turnover in directors for the next three years will create a void in terms of lost skills, knowledge and experience.

Unexpired terms are problematic in this proposal, as individuals selected to fill the remaining term would not even be able to achieve six years of tenure. As an example, a new director is selected to fill the last year of an unexpired term and is then re-elected to a new three-year term. The rule as written would restrict the individual from further service, as they would reach the six-year maximum in their next term.

The conflict of interest provisions found in §704.14(a)(4)(5)(6)(7)(8) are appropriate as written. However, we find these sections focus only on specific conflicts created among leagues and other corporates. The proposal does not address other examples of conflicts that may arise, such as conflicts of a business nature. Individuals with a significant business conflict of interest should also be excluded from service, when the conflict centers on a core business of the corporate credit union. Simple recusal standards are not adequate in these circumstances. The proposed rule should allow directors the right to

establish their own governance rules, to avoid serious and unworkable conflicts of interest.

Recommendations:

The titles of Chief Investment Officer and Chief Risk Officer should be added to the list of positions eligible to seek election or re-election in §704.14(a)(2). A sentence that permits the Director/Office of Corporate Credit Unions the authority to pre-approve other titles and approve other individuals determined by a corporate credit union's nominating committee to be qualified to serve should also be added to this section.

We recommend that term limits be deleted entirely from the regulation. However, if term limits are included in the final regulation then, at a minimum, they should be no less than twelve years. If a shorter period is approved in the final regulation, allowance must be given for those that have filled unexpired terms so as to not count that time against the service restriction.

Add to §704.14 the following conflict of interest wording: "A corporate credit union is permitted to develop a conflict of interest policy for its own governance needs, and such policy shall require the approval by the Director/Office of Corporate Credit Unions. Such policy may restrict Board representation and continued service wherein a conflict of interest is present."

**Area: Federal Register/Vol. 74, No. 235/ Dec. 9, 2009; Page 65275
§704.19 and Page 65263 §704.2**

Brief Description:

§704.19 Disclosure of executive and director compensation.

- (a) *Annual disclosure.* Corporate credit unions must annually prepare and maintain a disclosure of the compensation, in dollar terms, of each senior executive officer and director.

Discussion:

In the interest of the membership and in general with the theme of transparency, we support this measure. SEO is already defined in 12 CFR 701.14(b)(2) as, “a credit union’s chief executive officer (typically this individual holds the title of president or treasurer/manager), any assistant chief executive officer (e.g. any assistant president, any vice president or any assistant treasurer/manager) and the chief financial officer (controller). The term “senior executive officer” also includes employees of an entity, such as a consulting firm, hired to perform the functions of positions covered by the regulation.” This definition of Senior Executive Officer (SEO) is very broad as it relates only to titles and does not address the concept of “operational control” as has been the NCUA’s long-standing determination criteria for an SEO. The determination as to which employees are SEOs actually requires examining the “operational control” exercised by that employee and not just the employee’s job title. As an example, our organization has several vice presidents who do not meet the operational control test and report to senior vice presidents. We also have a controller that is not the CFO.

Recommendations:

The SEO definition found on page 64263 §704.2 should simply reference 12 CFR 701.14(b)(2) to remain consistent with definitions already set forth by the agency.

Additionally, we recommend that §704.19(a) include the phrase “senior executive with significant operational control” to focus the disclosure on the senior executives of the organization.

Another approach would be to simply require that the corporate disclose the top ten wage earners.